

2007 Year-End Report

Message from State Auditor Tom Salmon, CPA



January 2008

Dear Vermonter,

I am pleased to provide you with a report on my activities in 2007 since becoming Vermont State Auditor last January. **This job provides an important window on the fiscal condition of the State, our collective challenges, and our great potential.**

We conduct financial and special audits and receive many inquiries from citizens and legislators for action. My aim has been to remain fair, impartial, and objective while raising this Office to a level of productivity that can serve Vermonters well for years to come.

Our most significant effort is the annual audit of the State's financial statements, with a deadline of December 31 each year. This audit provides the public, the Legislature, and the financial community with independent assurance that the information presented in the State's financial reports is reliable. The audit also provides an opportunity for this Office to make recommendations for improvements to the State's accounting and reporting procedures.

One of my goals for the future is to restructure the office somewhat to permit our auditors to conduct more performance audits of State government programs and operations. While the financial audits are important, performance audits can identify opportunities to improve efficiency, deliver better services, and save dollars.

I also want to bring more awareness to some of our long-term financial challenges, such as the need to account for future health care liabilities related to retired employees, and so-called "other post-employment benefits." **Our past Medicaid audits identified nearly \$2 million in potential improper payments,** and I would like auditors to continue to work on the Medicaid program, the largest in State government.

I look forward to continuing my service with full commitment to our State's financial stability. I am pleased and proud to have a great staff, with some talented new additions, working on behalf of the State taxpayers and citizens. **Your comments and suggestions are always welcomed** and help guide our direction.

Sincerely,

Thomas M. Salmon CPA

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Vermont State Auditor

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*From State Street to Main Street
to School Street.*

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Here's what we've been doing ...

As your newly elected State Auditor, I have worked to improve the structure and staff of our 13-person department, and to look ahead to how our office could be more helpful to the Legislature and citizens in reviewing the effectiveness of programs as well as the proper accounting of revenues and expenses. Below is a brief summary of some of our work and initiatives thus far this year. – *Tom*

Audits of Vermont State Government Financial Statements and Federal Single Audit (A-133)

* We are working every day with State finance administrators to meet FY 07 Financial Statement Audit deadline of December 31, 6 months after year-end and 3 months after books formally "closed" on FY 07. A timely audit assists in maintaining Vermont's strong bond rating.

* We hired Joe Juhasz of Townshend to give sustained attention to reducing the number of *repeat* audit findings at State agencies which will cost an additional \$750,000 this year. Joe is working well with AHS and other departments to help ensure that problems are fixed.

* Hiring CPA staff to fill four critical vacancies.

* We met with the State's Business Managers on how to better prepare for audits to make them more efficient and less time-consuming.

* We've begun Federal funds compliance testing at the State's largest units: Human Services, Education, Transportation, and Natural Resources, as part of the Federal Single Audit.

Key Reports

* Audit of Vermont Dept. of Health and Selected Bioterrorism Hospital Preparedness Grants

* Brattleboro Multi-Modal Report – Review of Use of State Funds and Internal Controls.

* 2nd Medicaid Report (Physicians and Institutions) – nearly \$900,000 in potential overpayments highlighted.

* Report on Computer Security at Four State Agencies.

* FY 2006 Single Audit Report.

"Our Mission: Professional Audits; Financial Training; Efficiency and Economy in Government; Service to Cities and Towns."

*Tom Salmon,
Vermont State Auditor*

Financial Training

* We organized a very successful *State Auditor's Training Conference* on Tuesday, September 18 in Montpelier, with over 140 participants, and which included a fraud presentation by former State Auditor Randy Brock.

* Helped to establish the Vermont Municipal Advisory Commission (VMAC) which held trainings July 23 and 25 on Ethics in Government and Internal Controls in Municipal Finance.

* Our office is supporting regular monthly trainings held for State Internal Auditors and Business Managers.

Financial Training (continued)

- * Participated in a retreat with the State's business experts and staff to strengthen teamwork and core values.

- * Completed 10 consecutive months of training with the 14 County Sheriffs' bookkeeping staff to improve the accounting manual while unifying the chart of accounts and software.

- * Met with various Assistant Judges to ensure an improved audit process on the county level.

- * Met with various School Superintendents and School Business Officials to discuss fiscal challenges.



John Schempf, Rockingham interim town administrator, (left) leads a discussion group at the VMAC training workshop in Milton on July 25, 2007.

Service to Cities and Towns

- * We helped to resolve over \$400,000 in misdirected traffic ticket revenue in Newport and Rutland regions.

- * We are working with the City of Rutland to ensure improved Internal Controls and fiscal management.

- * Other towns we have assisted include East Montpelier, Highgate, and Moretown. In Moretown, I reviewed the town's draft audit report and later attended a town meeting with attorney Paul Gillies and auditor Fred Duplessis, CPA to help residents better understand the audit process and how the town could move forward.

- * We advised towns in July of prudent cash management strategies for \$135 million in one-time education-related payments from the state.

Public Policy

- * In recent newspaper commentaries, I discussed trends in the transfer of Lottery profits (about \$21 million in FY 07) to the State's Education Fund.

- * Our office is assisting the Attorney General's office in its investigation of the former clerk/treasurer of Isle La Motte.

- * We have worked to create a climate of cooperation and process improvement regarding a number of issues in meetings with the State's Joint Fiscal Office (JFO) and the Department of Finance and Management.

- * I testified at several legislative committee hearings during the past Session; my chief concern is looking at the fiscal impact of proposals so that legislators have additional viewpoints when deciding policy.



Auditor Tom Salmon congratulates Floyd Blodgett on receiving a Special Service Recognition Award from the Vermont Internal Auditors group. Blodgett was honored at the 2007 Auditor's Audit Training Conference held September 18, 2007, in Montpelier. Blodgett, who served the State of Vermont almost 30 years, retired last year from the Vermont Department of Education where he was an audit analyst. He and his wife, Louise, live in Berlin.

For more information, please visit our website at: www.auditor.vermont.gov

New Auditing Standards to Impact Findings and Costs

A new auditing standard from the American Institute of Certified Public Accountants (AICPA) and the Government Accountability Office (GAO) will impact many audits for schools, cities and towns, and State government. This was the message from Shawn Warren, CPA, of KPMG at the 2nd Annual Auditor's Training Conference in Montpelier in September.

"There are significant changes in store for government audit reports thanks to the new Statement on Auditing Standards (SAS) No. 112, entitled *Communicating Internal Control Related Matters Identified in an Audit*," Warren declared.

"The bottom line is that auditors will be spending more time documenting how they identified internal control deficiencies, how they evaluated these deficiencies, and how they reported them to management," Warren said. "The difficulty lies in the fact that the threshold for reporting a deficiency has been lowered – so, in other words, local governments and public entities will be seeing more deficiencies in their audit reports despite the fact that very little may have changed from last year to this year," Warren noted.

"You might now liken it to a high school basketball game where the referees seem to be calling everything," Warren quipped.

SAS No. 112 requires auditors to evaluate identified control deficiencies and then determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses. SAS No. 112 states that a control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned duties, to prevent or detect misstatements on a timely basis.

About SAS No. 112

- Issued May 2006
- Supersedes SAS No. 60
- Effective for audits of financial statements for periods ending on or after December 15, 2006 - June 30, 2007 audits
- Aligns AICPA literature with PCAOB literature
- Companion 'Audit Risk Alert'

Practice Issues

- Auditors need to make a clear change in their thought/documentation process for evaluation of deficiencies
- Auditors may need to gather more information to make the SAS No. 112 determinations
- Auditors need to educate management and boards regarding change

SAS No. 112 also states that auditors must communicate, in writing, significant deficiencies and material weaknesses identified during an audit. Given the revised definitions of significant deficiencies and material weaknesses and the requirement that they now be reported in the audit report, matters that previously may have been included in an agency's immaterial findings letter, may now be reported as report findings in the regular financial statement audit.

"Auditors should prepare the school board or town board members for the new standards which initially could make it appear that their financial controls have weakened, when the opposite might really be the case," Warren said. He noted after the conference that the new requirements will probably force audit firms to spend more hours on an engagement, perhaps resulting in higher bills.

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Ethics in Municipal Government

In all of the trainings we've co-sponsored this year, government ethics policies have been part of the discussion. We've posted PowerPoint presentations on the issue on our website (www.auditor.vermont.gov), particularly the one given by David Coates, CPA, at our September 18th conference. (Slide example at right).

David Coates' message was that a good ethics policy is not something you pull off the Internet and quickly "adopt" for your town or organization. It requires discussion time among managers and employees, with the public, review by counsel, and revisions along the way.

To make an ethics policy "work," there needs to be an environment throughout the organization that promotes integrity, and "doing the right thing." Along with the specific do's and don'ts of a policy, there should also be a strong whistleblower protection policy. There's no point in encouraging people to report questionable or suspicious activities if there's a chance that management's reaction could be punitive toward the person reporting.

Public policies and citizen expectations evolve, and manager and employee job duties will change due to new technology and new systems. A good ethics policy is reviewed in a timely manner, and amended where necessary, to keep it current and meaningful for all staff and the public.

Below are some Internet locations where you can find examples of good ethics policies and discussions about this critical issue.

Thanks. – Tom Salmon.

Ethics, conflict of interest & internal controls online!

<http://www.vermont-towns.org> – Links to homepages for all towns in Vermont. Some have policies on their websites.

<http://www.sec.state.vt.us/municipal/pubs/conflictinterest.html> - Vermont Secretary of State's site, includes model policy.

<http://www.vermontpersonnel.org/employee/policy> - State of Vermont Employee Conduct policy.

<http://ethics.wa.gov/TRAINING/quiz/ppquiz.htm> - Multiple choice ethics quiz.

HOW TO PREPARE AND IMPLEMENT A CODE OF ETHICS – SOME OF THE ISSUES TO ADDRESS:

- definition of conflict of interest
- acceptance of gifts / favors
- appointment / supervision of family or personal friends
- influence over subordinates
- use of confidential information
- recusal
- how to address complaints / potential violations

Down Mexico way ...



As part of his service with the Seabees in the U.S. Navy Reserves, State Auditor Tom Salmon spent two weeks this past summer working on the 700-mile long, 15-foot high steel fence on U.S.-Mexican border. The wall is being built to block illegal immigration and drug trafficking. While in Columbus, NM, Tom poured concrete into trenches that held the steel posts. "The military is very uncomplicated," Salmon said, "They call. You do the work. You go back home." Here, Auditor Salmon is pictured with Jeremiah, the driver of the cement truck.

Helping State, City & Town Finance Officials Improve Skills

Summer training sessions:

What the participants had to say

What follows are some of the comments we heard in group discussions about town and school district financial procedures.

“It might be a good idea to include Vermont’s anti-kickback statute and other important laws in your Ethics Manual or employee code of conduct.”

“New employees should have to sign a certification that they have read the Town’s ethics policy, employee conduct manual, whistleblower policy, etc., and that they understand the documents.”

“Should a town let employees take home tools and equipment for the weekend for a personal home-owner-type project? I don’t think so – but it happens. A lot of times no one notices, and it may be a longtime, trustworthy employee, and nothing gets broken, but the public perception of special treatment comes out when it’s discovered. The Town Board should have a policy – no loaning tools out – or it should say what tools, which employees, and what happens if something gets broken.”

“A code of ethics helps good employees actually; if they are accused of something, they rely on the code of ethics, and the procedures they are following, to defend themselves. No matter how trustworthy your reputation is, without procedures in place you are at risk of a false claim against you.”

“Outside audits of a town or city might miss some key ethical concerns; for example, is the financial office efficient, or is there abusive waste that could easily be corrected? This situation might not show up in a typical audit or management letter. Yet an unethical situation festers on.”

“In our town we have concerns about members of the Select Board who go around the town manager with instructions for office staff, which puts us in a tough spot sometimes.”

“Our ethics policy for employees is way out of date; for the board, there is no ethics policy that they have adopted.”

“The Vermont Selectman’s Handbook, from the Vt. League of Cities and Towns, used to be \$20 and now it is online. People should make sure that new Select Board members get their own copy and read it.”

“A lot of Select Board people have daytime jobs; they don’t sign up for training days. It needs to be encouraged more. Government can get complex.”

“A town library trustee wanted to have his late charges for his property tax payment waived because he was on a town board. A good response to that is, “You are asking me to violate the code of ethics for my Office and I can’t do that. In addition, if I did it for you I would have to do it for everyone.”



Participants at a July workshop in Manchester presented by the Vermont Municipal Advisory Commission and the Office of the Vermont State Auditor listen to a presentation on “Internal Controls” by Stephen Love, CPA, of Fisk, Reed and Love, P.C., of Bennington.

“Our town is too small to see bribes – everyone would know about it in a few hours!”

“There are good audits thrown in the drawer and nothing is done about them; there are bad audits that have no value and they are also thrown in the drawer. We need a third type of audit – the one that was of value and where management developed a constructive action plan to follow through on the recommendations.”

“There are a lot of little issues that you sometimes don’t think of as ethical concerns. When a vendor takes the town manager to lunch and pays for the manager’s lunch, is that okay? Is there a perception there about a quid pro quo of some kind? Do towns have policies about gifts from citizens or vendors? Is there anything wrong with free coffee and a donut for the police chief at a certain restaurant 2 or 3 times a week?”

“It would be good for the city to inform vendors right up front, on a website or wherever, that the City has a no-gifts policy. The rules would help the vendors, too.”

“In small towns, nepotism is an issue. It should be addressed clearly because it happens a lot. A person may end up working in the same department as another relative, but one relative shouldn’t have a hiring decision on another relative, or even a supervisory role over a relative. When the niece of a school board member gets hired to teach 4th grade, the Superintendent and Board should have excellent documentation on how they made that decision, because they *will* be asked about it by the public.”

“The management letter of a town audit is public

information, as is the whole audit report. I think the standard phrasing of the auditor’s letter – that the report is intended only for the Board – should be changed to language that clearly indicates that while the report may be done *for* the Board, it is a public document and is available by request.”

“A lot of town and city expenditures revolve around payroll, so the town or city needs to have a really good personnel policy – this is a key to fair treatment for all employees. There are a lot of issues that come up with personnel actions – overtime, holidays, call-ins, compensatory time, pay raises, terminations, and everything. The business office is greatly assisted in all this with clear personnel policies that have been approved by the Select Board.”

“A coach at the school wanted to have his coaching pay not be part of the payroll account. We said no. All wages and salaries go through the payroll system – not the independent contractor system.”

“Inventory control, like an annual inventory of computers, equipment and other assets, is good to do.”

“When the Select Board approves warrants to pay bills, it’s a good idea to have the minutes of the meeting indicate the warrant number and the total amount of the warrant. This helps when you look back.”

“The signatures on the warrant should be right under the last item – so that no one in the office can add an item to the warrant after the meeting.”

“Without policies, people make it up as they go, and sometimes that’s not good.”

Sheriffs Departments adopt common accounting software

Six county Sheriff Departments audits due soon

The State Auditor's Office has worked with the Sheriff Departments and the County Assistant Judges to set up a schedule for mandated audits of the Sheriff Departments every two years. This group has also worked together to contract with an independent public accounting firm -- McSoley McCoy, Inc., of South Burlington -- to perform the required audits.

Financial statement audits for the fiscal year ending June 30, 2007, will be conducted for the following County Sheriff's Departments: Bennington, Chittenden, Orange, Washington, Windham and Windsor.

For FY 2008, the financial statements of the remaining eight County Sheriff's Departments will be audited:



Addison, Caledonia, Essex, Franklin, Grand Isle, Lamoille, Orleans, and Rutland.

"We will be posting all the County Sheriff's Department audits on our website when they are completed," State Auditor Tom Salmon said. "This has not been done before and it will give taxpayers a better view into the

activities, revenue, and expenses of their County Sheriff's Department."

Salmon noted that his Office has been working with the financial staff of all the County Sheriff's Departments to revise its uniform accounting manual and to adopt a standard financial software program.

"With a standard software package, we'll be able to audit the departments more easily, and provide useful comparison data to Sheriffs and their financial staff. A key benefit will be that all the bookkeepers can be trained on a single system and they can share information easily with phone calls and e-mail. We should see more efficient, up-to-date financial procedures in all the departments," Salmon noted.

After a public RFP process, the departments chose QuickBooks Premier 2008 accounting software as their common system. Training on the new system took place in November.

"I am very proud of everyone's efforts to work together to improve financial training and expertise," Salmon said. "The Sheriffs and their staffs deserve praise for extra efforts to improve their systems and provide more accountability to the citizens."



Judi Gross, Washington County Sheriff's Department bookkeeper, works at her desk at the department in Montpelier recently.

"The Sheriffs and their staffs deserve praise for extra efforts to improve their systems and provide more accountability to the citizens."

- Tom Salmon

Links to our reports and selected opinions

Report #	Title	Issue Date
07-01	Vermont County Sheriffs' Departments: Compilation of Reports on Financial Transactions & Conditions at Vermont's County Sheriffs' Departments for Fiscal Years Ended June 30, 2004 and June 30, 2005	1/3/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/16
07-02	Computer Security: Results of Review at the Department of Information and Innovation	2/15/2007 Confidential
07-03	Computer Security: Results of Review at the Agency of Transportation	2/15/2007 Confidential
07-04	Computer Security: Results of Review at the Department of Taxes	2/15/2007 Confidential
07-05	Computer Security: Results of Review at the Department of Labor	2/15/2007 Confidential
07-06	Brattleboro Multi-Modal Project: Review of Proper Utilization of State of Vermont Funding and other Observations	4/25/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/16
07-07	Fiscal Year 2006: Report on Internal Controls Over Financial Reporting and on Compliance with Laws and Regulations	2/22/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/14
07-08	Medicaid - Needed System Improvements and Questioned Payments Identified	5/8/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/16
07-07	Vermont Department of Health -- Selected Bioterrorism Hospital Preparedness Grants	8/24/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/16
N/A	FY 2006 Single Audit - "State of Vermont -- Auditors' Report as Required by OMB Circular A-133 and Related Information, Year Ended June 30, 2006"	3/30/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/14
Opinion	Accounting & Financial Reporting for Income Sensitivity Adjustments Related to Property Taxes	4/2007 http://auditor.vermont.gov/interior.php/sid/3/aid/17
07-11	Vermont State Colleges— Leasing of Educational Broadband Services (EBS) Spectrum & Competitive Bidding Review	11/2/2007 http://auditor.vermont.gov/interior.php/sid/2/aid/13/nid/127